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IMPACT OF THE 1980'S ON THE FINANCIAL POSITION OF STOCK COMPANIES

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1. Will the impact of the force of competition on price levels and profit margins continue to be heavy throughout the 1980's? What would be the likely effect if this trend continues?

2. Will the market for life insurance and annuities grow as rapidly as Company growth objectives demand? If not, what will be the likely results?

3. Will a continued high level of inflation create a serious profit squeeze on stock companies in the 1980's? If so, what options and reactions are available?

4. Will the smaller stock companies face problems in the 1980's which may strain their abilities to compete and/or survive? If so, what steps can managements take?

5. Will permanent versus term pricing practices and profit margins change during the 1980's? Will management's opinions of profit sources be subject to change?

6. Will the future source of Company surplus growth be similar to that of the 1970's? Will higher or lower surplus levels be appropriate in the 1980's?

7. How will "free surplus" be used? Will investments in new life insurance business continue to be more lucrative than any available in the capital markets?

8. Will life insurance companies continue to be attractive acquisitions in the 1980's?

MR. DAVID P. VANDERSCOFF: Our first panelist is John Tiller from Occidental Life. John graduated from Harvey Mudd College in California in 1969 and he has been in the life insurance business for 12 years, starting out as an agent, interestingly enough for Pacific Mutual. During the last 10 years, John has been with Occidental. John, let us hear about Scenario A - High Inflation or Momentum.

MR. JOHN E. TILLER: Thank you, Dave. I was a little surprised when Dave asked me to participate in this panel because I never considered fortune telling to be one of my strong points but the hazards of reinsurance are such that you often end up with rather long dinners with a few bottles of wine. Somewhere in the course of one of these, Dave and I got to discuss something and I guess he thought that what we said was rather profound. If you have a little trouble following this, I suggest you buy a copy of the tape and somewhere around 10 o'clock at night have a bottle of good California Cabernet and listen to it.

I would like to review certain of the components of the High Inflation Scenario that I consider deserve special attention. Take these in three groups.

First, consider:

- Increasing "Entitlements-Consciousness"

- Increasing "Present-Mindedness" and

- Continued Double-Digit Inflation

Taken together, these undermine the individual's disposition to buy insurance. Increasing reliance upon others to provide security -- and increasing willingness of those "others" to provide -- obviously reduces the probability of someone developing a personal security plan. Add to this an increased pressure to consume today and the need to save or invest for the future will be continually and constantly undermined. Combine this psychology with the impact of high inflation and current non-participating whole life policies become extremely unattractive propositions.

Next, consider:

- Repeal of the McCarren-Ferguson Exemption

- FTC Cost Disclosure Requirements

- Increased Consumerist influence

These items create an atmosphere where competition for the so-called "savings dollar" is intense between insurance and many other vehicles. There is a high probability of total federal regulation with full cost disclosure. The additional regulation, compliance requirements and consumerist activity also means higher expenses. Through all this, we see the tide of events going against the advisability of long term, fixed dollar investments of a relatively low yield -- say less than 10% -- such as traditional cash value insurance. We also see the inadvisability of trying to sell -- as an investment -- any vehicle where the return is delayed many years into the future. Not only is the 10-year of 20-year interest adjusted return going to be important, but also the immediate liquidity of a purchase will be of paramount interest.

Finally, consider:

- Higher Dependency Ratio, and

- Change in the Tax Environment

These indicate an even heavier tax burden to be borne by the individual, thus restricting the amounts available for savings. When taken together with wage indexing, income tax indexing and national health insurance, it becomes difficult to conceive of an environment where people would willingly spend a significant portion of their income on life insurance, especially as an investment vehicle.

Now let us investigate some of the major implications to our industry. The public will tend to look more and more to life insurance as it does to property and casualty insurance or to health insurance -- as indemnification for a loss -- in this case, the loss of potential income. While group insurance and social insurance will provide ever larger portions of this need, significant sales can still be made to those not adequately -- or perhaps not even partially -- covered by these plans. Cash value or savings -- oriented insurance will be bought only when competitive with other investment vehicles or when significant tax advantages exist.

This interpretation of the future leads me to the conviction that by 1986 we will see that the products sold by stock companies will take one of the following forms:

1. Term insurance of many forms and options.

2. Plans with some tax preferred aspect such as the retired lives reserve product, an estate tax policy or individual pension plans. In this area, we might see a traditional non-par, whole life product, although probably with some new bells and whistles.

3. Indexed coverages--either permanent or term plans with an index feature to provide for replacement of income which is indexed.

4. Traditional fully participating plans.

5. Plans which offer some degree of interest participation. These could take either of the following forms:

   A. A non-guaranteed product where the rates are adjusted with interest changes.

   B. Some combination of term insurance with an annuity package, such as Universal Life, where the investment element is easily separated from the life insurance.

As I continue with this scenario, I see the elimination of "interest gains" as a major profit source for stock life companies in the 1980's. Instead, we will take an asset management fee and on products where we guarantee against the loss of principal, a fee for that guarantee. Much of the gains in the past decade or two have come from investment returns which were highly in excess of those assumed at the time the product was priced: That is not a reasonable expectation for the future. We should see an era of heavy price competition. For example, price competition in the term brokerage market has in many ways just begun. Because of the shift in emphasis from an investment orientation to a pure death risk coverage, we will see much innovation in product design with many companies willing to take a very low profit to gain or maintain a significant market share. Competition on interest participation products will be largely based on investment performance, much as mutual funds compete on their past history or as participating policies compete on their past history or as participating policies compete on dividend history.

Another probable change in profit margins is to lower average annual profits, but this will be compensated for by a lower investment in new business. Strain, especially cash strain from commissions and expenses, must be reduced if we are to cope with high inflation. This is necessary if our companies are to get a return on investment greater than that possible via traditional investments such as stocks, bonds and mortgages. Return on investment will become perhaps the major pricing criteria of the future for any product which involves an investment.

This will lead to the development of many products which cause no strain to the company, leading to different types of pricing considerations, perhaps we will even promote efforts to define profit in relation to risk. (A lot of actuaries may go grey trying to figure this out.)

Much of the next decade we will see companies with very serious cash flow problems. Most companies are experiencing this already due to surrenders, increasing expenses, high acquisition costs and old, low yielding investment portfolios. In fact, I expect some insolvencies and near-insolvencies to occur, not as the result of operating losses, but from asset value shrinkage and the need to liquidate assets at a market value somewhere between 60% to 80% of the book value.

In short, I see a need in the 1980's for new products and new distribution systems, with more emphasis on the term element and almost complete investment participation by the policyholder. The policyholder will demand early liquidity and a return on his investment. This implies a need for much lower acquisition costs and perhaps level commissions.

Our industry needs to demand flexible and realistic treatment by the regulators--both state and federal--and by the IRS. This is necessary if the industry is to be flexible enough to meet the new demands of a new era. Our valuation system needs to be clear on the treatment of flexible rate structures where we can guarantee either the rates, but not the cash values, or the cash values and not the rates. We need to develop indexed coverages. If the nation has indexed wages, then it is logical that the coverage to replace those wages also be indexed. Perhaps we should even index the rates themselves, say as a form of non-guaranteed rate program with automatic adjustments based on interest.

By the end of the decade, much of the price competition will be shaken out. The industry will have a new track record and will move to competition on different levels, such as side fund performance and services. There will be a growing market for term insurance as inflation continues to force up the replacement cost of the human life, but at the same time there will be a shrinkage in the use of insurance as a savings vehicle. Incidentally, we will see this contraction in all forms of savings, not just in life insurance. The concepts of Entitlements-Consciousness and Present-Mindedness have a negative impact on industries other than life insurance and the problems created are not unique to us.

Sources of profit will obviously change with the gradual elimination of interest rates and the introduction of new products. Hopefully, the smarter companies will use the so-called "excess investment earnings" now being generated to finance a new wave of business either through new distribution systems or products or with a gradual shift in mix. There must be more demand for tight administration and management. We have realized tremendous savings in the past decade with the introduction of high-powered computers; this will not necessarily continue. If we have reached bottom on computer savings and with the cost of human labor escalating so rapidly, the only way we can limit our expenses is with controlled and innovative management.

Given the above--especially the cash flow problems and high lapses, it will be very difficult to generate growth, and some companies will find it hard to maintain even level profits with a shift in new business from permanent to term. First year premium totals are likely to decrease, not increase. As in force portfolios shift from permanent to term with different deferred acquisition costs and amortization schedules, GAAP earnings could be substantially lowered in some companies. Since insurance companies will not be able to generate the positive cash flow of even five years ago and will have difficulty maintaining GAAP profits, many companies will be sold at bargain prices.

The average insurance company will not continue to be the attractive acquisition of the immediate past. Ownership will seek high returns, so management will have no alternative but to use lower surplus levels as targets. Tools such as stop loss will be used much more frequently to protect the solvency of a company instead of surplus.

A company will have three major options for the future:

1. It can adapt. By this I mean it can specialize, identify a favorable market segment and concentrate there. According to at least one recent marketing study, the companies which have shown the highest return on equity over the past decade are those who identified a specific market and concentrated in it. This implies that many companies should cease trying to be all things to all people and eliminate some lines of business. This doesn't mean we should necessarily drop our individual health line, for example, but that we should look at each line and determine its true profitability. In fact, one of the things possible to improve earnings is to add marginal lines if they are truly marginal, if the cost can be contained and if the return can be generated quickly enough. Cost control is a part of the adaptation, as is a careful review of the return on investment in new products.

2. It can merge or consolidate. Those companies that cannot adapt reasonably will have to find a merger partner or consolidate operations in some way if they wish to continue to exist.

3. It can liquidate. Those companies which cannot adapt, merge or consolidate will be forced into liquidation. Many companies will be liquidated because their owners will find this generates the best long-term return. At least it will generate funds for use in other areas.

According to recent industry publications, there has been a growth in new companies over the past couple of years, but is this growth real? Many of these companies are shells of some sort or speciality subsidiaries of a major company. Many of these will disappear in the future and even today have no real market impact. The number of real operations--if you consider all companies under one corporation or one owner as one operation--is shrinking and will probably continue to do so into the future.

I do not mean to appear overly negative in these comments. There are many opportunities for positive action if we in the life insurance business can work closely with each other and with the regulators to develop products which meet the needs of the individual buyers and produce an adequate return to our owners. Whether this is to be done through the options I have outlined above or others that are equally valid, is for each management team to decide. None of the three scenarios discussed today are likely to be absolutely true, so none of the problems or solutions we present are entirely accurate. While I do not like some of the problems we are facing, this environment is personally challenging and it is gratifying to realize I have at least another decade of excitement before me.

MR. VANDERSCOFF: Thank you very much, John. I am looking forward to the challenge as well, whether it is inflation or one of the other scenarios. We will see what happens.

Our next panelist is Paul Overberg who is with Allstate Life. Paul is Senior Vice President and Chief Actuary. Paul graduated from the University of Michigan in 1950 and has spent the last 30 years in the life insurance business. During his first 11 years, he experienced participating insurance in three mutual companies. During the last 19 years, he's been with Allstate which, incidentally, issues no participating business. Paul, let's talk about Scenario B - Incentive and Investment.

MR. PAUL OVERBERG: As Dave indicated, my remarks will cover the entire subject matter listed for this concurrent session with the viewpoint that Incentive and Investment Scenario will evolve.

The statements I will make are not necessarily what I or my company believe will, in fact, happen. They are made with the hope of stimulating your thinking and fruitful discussion.

After starting out with such cautions, I would like to state some things I am very confident of:

1. Old Faithful - America's favorite Geyser will continue during the 1980's to spout off about 50,000 gallons of water every 75 minutes; just like it's been doing for the last 20 million years;

2. The Windy City will still be windy throughout the 1980's. When mother nature stops blowing, the politicians will take up the slack, and

3. The fruit-flavored life savers will still be packaged in the same order they are today, i.e., orange, red, yellow and green.

4. I am also confident that nonparticipating - guaranteed cost whole life insurance will be alive and well throughout the '80's - despite Jim Martins' statement to the contrary.

While preparing for this panel, I ran across an article on smoking in the Atlantic Monthly. Here is a short excerpt from it:

> "Almost all confirmed smokers will go so far as to wish they had never acquired the habit. Few of them desire their boys to acquire it. None recommend it to other men."

That statement was published 112 years ago. It was taken from an 1868 issue of the Atlantic Monthly.

Some things never seem to change. Yet, in the last day and one-half, I am sure most of you have become convinced - if you were not already - that there are going to be many major changes facing us in the 1980's.

In my opinion the major driving force of much of the change in the 1980's in the life insurance business will emanate from consumerism.

In April of 1968, Senator Hart was the featured speaker at the American Life Convention meeting at the Edgewater Beach Hotel in Chicago. He warned the industry of the consumer concerns which he envisioned, and if the industry and/or the states did not act, then he would introduce a federal truth in life insurance law.

Today, 12 years later:

- Senator Hart no longer exists,
- The ALC no longer exists, and
- The Edgewater Beach Hotel no longer exists.

But, consumerism in life insurance is alive and well and growing stronger every day. It has already created a competitive element the likes of which we have never before witnessed.

Price and cost competition will intensify over the next few years.

Agents will be required to give cost indexes before the application is signed.

Shoppers' guides will continue to be published and will continue to emphasize whole life and level term insurance.

Yardsticks will be published and distributed by some state insurance departments. But under this scenario the courts will by 1985 declare it is unconstitutional to require any agent or company to give directly or indirectly cost information or ranges on competitors products.

Current low mortality costs and current high interest earnings will add fuel to this competitive environment.

With the current higher interest levels, the interest rate used to compute surrender cost and net payment indexes will be raised in the early eighties. This will help to equalize the competitive position of non-par policies.

These factors will drive life insurance rates to historic low levels.

Then, under our scenario, interest rates will drop. Profits will drop and, for some companies, the drop in profits will be disastrous. It will be worse under GAAP earnings than under statutory earnings.

- The low premium rates in the early 1980's will intensify the replacement of policies issued only a few years earlier;

- Older policies with relatively high profit margins will be replaced with new policies with lower and lower profit margins as the churning process continues.

- The companies with the low premium rates in the early 1980's, with low surplus margins, and with liberal assumptions in their GAAP reserves, will be the most likely candidates for financial disaster;

- The assumptions used in GAAP accounting, and the lag in updating lapse rates when they are on the up-side and interest rates when they are on the down-side, will come under close scrutiny. Some large blocks of old business still remaining on the books will be determined to be unprofitable and all future losses must be reflected in the current years' statement. Huge losses could result in stockholder suits which will add to the company's financial difficulties, and some auditing firms and their actuarial arms will be held jointly liable:

  - This adverse publicity will drop the value of the stock of life companies;

  - Larger and well-capitalized companies - both stock and mutual - will acquire the smaller companies at bargain prices.

  - When interest rates drop, there will be a lag before interest rates used to compute the cost indexes are reduced. Thus, the non-par policies will have a better competitive position for a period of time.

Under this Incentive and Investment Scenario, the Federal Government will leave the regulation of the insurance business to the states.

- State regulation will, during the first few years of the '80's, concentrate on cost disclosure and related consumer issues.

- The current pressure to adopt variable interest rates for reserves and nonforfeiture benefits will never get adopted because of the falling interest rates;

- The current pressure for lower and lower rates on whole life policies is currently encouraging some stock companies to adopt the flexible premium concept in order to avoid deficiency reserves.

  This will alleviate the surplus drain in the statutory statements. But, it will have only a minimal effect on the GAAP statements. It is the older profitable policies that are subject to replacement, and as they go off the books, the GAAP surplus is lost;

- After several stock companies are in financial difficulties, state regulators will, once again, focus on their main responsibility - that is:

  - One of solidity rather than
  - Low cost products.

The manipulation issue will first show up as one of terminal dividends on participating policies. This will quickly result in most terminal dividends starting out at a more modest amount, and increasing more gradually than is now seen on some par policies.

However, as interest rates drop, participating policies and the flexible premium non-par policies will lose their glamour. The public will become more aware of the non-guaranteed nature of these contracts and the manipulation issue will shift to this problem.

This will greatly enhance the image of guaranteed cost non-par policies. Some such policies issued in the early 1980's will prove to have lower cost than many par and flexible premium non-par policies. This will cost the stock companies some profit dollars, but the effect on the image of guaranteed cost non-par whole life insurance may well be worth the price.

As the solvency problems begin to emerge, and consumerists will quickly change their focus away from cost disclosure and concentrate on such issues as the lapse rates in early policy years on cash value policies.

The mechanics for showing these lapse rates in the statutory statement will be in place before the mid 1980's.

Another consumer issue receiving attention will be the commissions paid on term compared to what is paid on whole life.

> Many companies will - in the early '80's - have increased the new business commission rate on term insureds' to the whole life level. But, some consumerists will push for:
>
> - Equalization on renewal as well as first year, and
> - Equalization of the dollar amount of commission per $1,000 of insurance protection rather than an equal % of premium;
> - This will tend to change the relationship between the rates on term and whole life policies. Thus, "buying term and investing the difference" will become less attractive to more and more potential customers.

These two issues:

- High early lapse rates on cash value policies, and
- Equalized agents' compensation,

will add to the woes of the poorly managed companies.

Those stock life companies that have adhered to sound management and actuarial principles will emerge through the 1980's in an excellent position.

- The number of companies selling life insurance will be greatly reduced;
- The public will better understand how to measure the cost of the protection they are buying. They will have a better appreciation of the services that the good agents and companies provide.

The financial problems of some of the life companies will:

- Put competition in a more realistic place, and will

- Emphasize the continuing need for good management - and operations based on sound actuarial principles.

The life insurance market will grow during the 1980's:

- The demographics indicate the growth in the insurance-buying ages will be very rapid in the first half of the 1980's;

- The lower interest rates and the economy in general will increase family formations and homeowning - the things that make people want life insurance;

- Inflation of the 1970's will leave most Americans considerably under-insured.

There will be many product innovations.

Profit margins will be respectable - but lower than most stock companies enjoyed in the late 1970's.

- The excess interest earnings on the old blocks of business will be greatly reduced both quantitatively and qualitatively.

- The profit margins on new business will be at a lower level, and

- The GAAP assumptions on new business will be more conservative.

This scenario spells woe to those companies that fell into the trap of believing:

"If the ABC stock life company can sell it for "X", then we can sell it for "X" minus "Y"

On the other hand, this scenario sets forth a bright future for those stock companies that have been, and continue to be well managed, and that have followed sound actuarial principles.

MR. VANDERSCOFF: Thank you, Paul. The next panelist is Glen Gammill who is with Peat Marwick, Mitchell & Company. Glen is a partner with the firm and his title is Practice Director in the Insurance Actuarial Division. Glen graduated from the University of Texas in 1965; and, for the first few years of his insurance career, he worked for the Aetna and Franklin Life. Glen is both an FSA and CPA, and he has worked the last ten years with Peat Marwick, Mitchell. Glen, can you tell us about Social Democracy - Scenario C.

MR. GLEN M. GAMMILL: Early in February, Dave Vanderscoff, our moderator for this Concurrent Session organized a conference call between the members of our panel for the purposes of discussing the organizational approach our group should utilize and of assigning each member of the group with one of the three scenarios being considered at this meeting. Unfortunately, at the time of the call, my advance preparation had been less than thorough and, hence, I was assigned Scenario C. While Scenario C, to many of us, may be repugnant to our independent nature and spirit of free-enterprise, we cannot ignore the trends in our business environment today that give some credence to many of the conditions present in Scenario C. By way of review, the Scenario C environment includes the following characteristics:

1. Howard Mezenbaum is President of the United States.

2. A national policy of "Northern European Social Democracy" which purports to emphasize a high standard and quality of life for all.

3. Certain specific conditions are:

   a. Federal Government economic policy which exerts control over supply and demand via wage/price controls and a value added tax or VAT. The inflation rate has dropped to 5 percent.

   b. A Federal Consumer Agency with broad jurisdiction over the marketing of all forms of insurance coverages.

   c. Tough anti-trust laws in many large states requiring any business that has more than 25 percent of the total market for more than three years to be broken up.

   d. National Health Insurance (NHI) has been enacted with the government as the only insurer and with all hospitals having been either nationalized or taken over by state government.

   e. Trend toward "working capitalism" whereby unions routinely bargain for seats on corporate Boards, and workers are given first priority during the corporate liquidation process.

4. The concept of "Voluntary Simplicity" becomes the dominant social value in the United States. Such a concept de-emphasized "conspicuous consumption" and the pursuit of an increased "quality of life" becomes the dominant social value.

In my opinion, Scenario C connotes a decline of the emphasis on economic growth as a significant measure of success. Wage/price controls, tax on the consumption of goods and services (VAT), a strong Federally supported consumerist movement and the apparent reduction in concern over future inflationary pressures would surely have a significant impact on the insurance needs in the marketplace. For example, the rate of growth in the average size of life insurance in force per insured family has increased almost 100% in the last 10 years, which may, in large part, be due to inflation. With inflation at 5% per year, limitations on the prospective purchaser's wage and a Federal tax directly related to consumption (VAT), the need for an ever increasing amount of insurance may not be present in the market psychology of Scenario C. Again, with the introduction of a VAT the tax position of both the insurance company and the insured will change so dramatically that products formerly marketed because of tax advantages under the current Internal Revenue Code may cease to exist.

The Federal Government's role in Scenario C is truly overwhelming. By direct competition in the health insurance arena (NHI), a significant market segment has been expropriated. Surely, the threat of further government expansion into other insurance product lines cannot be totally ignored under a continuing Scenario C environment. Not only has the government directly influenced the market by wage/price controls, VAT, etc. ... but indirectly through such tools as the new Consumer Agency.

In my opinion, the marketplace of Scenario C will demand simple, look-alike products marketed by highly competitive and efficient financial service organizations. The various functional areas of each financial service organization, including the marketing function, will be organized to properly address the market segments targeted by the organization. In marketing, in addition to exploring alternative forms of product delivery, the agency compensation system will need to be modified to stress policy persistency as opposed to total emphasis on the production of new business. The marketing department will also need to explore ways to uniquely distinguish what will essentially be "look-alike" products from other competitors. An example of this type of marketing tool is reflected in the recent decision of a major insurance organization to offer its life and health insurance customers with wallet size copies of their own electrocardiograms. The underwriting department in Scenario C will be extremely important since excess investment income as a major source of the insurance company's income will, in my opinion, deteriorate in the future. Hence, the ability of the insurance company to achieve favorable underwriting results may be an extremely critical source of insurance company earnings in the future. Service departments such as policy owner service and claims will have to continue to achieve operating efficiencies while at the same time complying with the ever-increasing requirements imposed by Federal and state authorities within the Scenario C environment. Due to the probable continuation of the trend towards shorter term insurance products, the investment department of the 1980's will need to assure the senior management of the insurance company that the investment department can achieve articulated investment strategies consistent with the contingencies underwritten. Each of the financial reporting and analysis departments such as actuarial, accounting and EDP, will need to continue to improve the company's data base and accounting procedures such that all necessary information required by the company's management and Federal and state regulatory authorities is available in a timely fashion.

Included in the program were a list of the following specific questions to be considered under each scenario:

1. Profit Margins and Price Levels - Prices and profit margins should continue to drift downward and begin to level off by 1986. The VAT, government interference and public attitudes will mean competition in other arenas, e.g., company image ...

2. Growth - The financial growth of the life insurance company will become more dependent upon management's ability to achieve operating efficiencies as opposed to increased sales volume. I believe that the industry will undergo a "shakeout" over the next 5 to 10 years.

3. Inflation - Under Scenario C the non-par/prospective-rated policy both long and short-term varieties, will be the key product line of the future.

4. Survival of Smaller Stock Companies - In my opinion, for each of the scenarios under discussion at this meeting, those small stock companies with dominate positions in either limited market segments or special product lines will have a reasonable chance of survival. Other small stock life companies with standard product lines will either be acquired or have their business merged into larger financial organizations.

5. Pricing Practices - The marketplace (consumer/government), in large measure, will dictate the price of "look-alike" products. The assumptions used in pricing will be tied more closely to the financial results of the company and the performance of management will be evaluated in terms of their ability to meet predetermined objectives contained in the pricing process.

I suppose that each of the three scenarios discussed at this meeting could ultimately become realities. However, in my opinion, the scenario of the future (Scenario D) will be the product of our own doing. I wholeheartedly support the comments of the Chairman of the Texas State Board of Insurance, the Honorable William P. Daves, Jr., who said; "If the industry would have less or limited government control of the business of insurance, then industry must have an active role in solving the problems of consumers. If the industry wants less government interference, then it must do a better job of governing itself."

MR. VANDERSCOFF: Thank you Glen. Glen, just because government is growing under Scenario C even more than it is now (we have big government already); just because Scenario C spells loss of individual freedom, decreased free enterprise system, eventual demise of free enterprise, you can't have fun under that?!

There have been some comments expressed by some of our panelists and some concern as to whether we really are following the scenarios as they are laid out because there seems to be similar ideas, similar themes, and similar types of solutions within each scenario. I contend that they are following the scenarios, but there are pervasive themes and solutions throughout each scenario, as there would be in any scenario.

As Mr. O'Toole said it so well, the key to survival in the 1980's, as it was in the 1970's but even more so, is strong management teams following basic, sound management principles. These management teams, as he said, must plan, plan, plan. Further, I agree with Gary Corbett that, in the future, management must be courageous and adaptable. Certainly in the 1980's, as in prior times, sound actuarial principles will be of vital importance. We must maintain and improve our ability to change direction more quickly than in the past and effectively. Along with improving management, of course, as a whole, we need good people--top people in all levels of management. We need to have responsive computer capabilities--not computers that run our lives or our businesses. We do not want the tail to continually wag the dog! We must have computers that can respond promptly, quickly to change. Finally, in the 1980's, more so than ever before, we must streamline our operations and become far more efficient, or as we have heard, pervasive in all the Scenarios, there is going to be a lot of companies that will not be around at the end of the 1980's.

Now, for the second portion of our program, I would like to hear from our panelists if they have any comments about any of the other scenarios or any questions they might have from any of the other panelists. John, would you start.

MR. TILLER: I would just like to say that my first comment was going to be on the need for good management, but you have already expressed my thoughts so much more eloquently than I ever could that I just have to say "Amen". I guess the first question I have of my fellow panelists is on the need for what I call 'short term liquidity' and 'savings elements of programs'. Under our current products it is often 7, 10 or 12 years before the cash value (if we want to continue to call it that), equals the sum of the premiums paid in. This obviously isn't true of some of our major competitors, such as the savings banks. Under my scenario on high inflation, I felt we were going to have a need for almost immediate liquidity. Can either of you gentlemen react to that need under your scenarios?

MR. OVERBERG: Yes, John, I agree that the structure that we traditionally had between our permanent and our term products has to be changed, and it will be changed; even in our current cost disclosure discussions dissimilar plans of insurance. The public is using it more and more to compare dissimilar plans and the comparison is going to be that of looking at a whole life policy compared to a term policy, the cost that you are paying under the whole life should not be more than what it is under the term in a dollars in and dollars out type of approach. This does spell out more towards levelizing the first year commissions and under your High Inflation Scenario you almost have to go for profits in the first year because you are going to have a hard time amortizing those acquisition expenses in an increasingly high inflation--so, I agree there has got to be more equalization towards that way. John, are you saying that because of the discount on the premiums the policyholders might be intimidated and might withdraw the cash values because he does not have full value in there yet?

MR. TILLER: I am saying that he might not even buy our product. A recent Wall Street Journal article had a report concerning this liquidity problem as relates to savings and loan profits. One savings and loan institution reported 60% of its profits were related to penalties charged to policyholders withdrawing and putting savings in money market funds. There was no intimidation with those having savings and loan bank accounts for them to pull the money out even under penalty because the interest rates were just so high in other areas. It was interesting that 60% of the profits of that savings and loan institution related to penalties on withdrawing money. It reminded me of profits made on surrenders where life insurers are releasing high reserves and paying low cash values.

MR. GAMMILL: Yes, I would like to make a couple of comments about what John said. One was relative to the fact that he hoped that companies would use the excess interest income that they are making now to invest in new product lines for the future. I have seen a lot of companies in the 'hinterlands' out there that are actually funding loss leading lines of business right now and as a matter of fact, if you took away the excess interest on funds behind the reserves and interest income on capital and surplus, those companies would be shocked to see what the bottom line looked like. I can see that with adverse experience, probably the GAAP numbers will come back a little bit harder than they would have ordinarily.

MR. HENRY RAMSEY: Paul, I would like you to clarify your statements about seeing non-par products still here over the ten year period and being alive and well. Do you really mean the traditional form of the non-par product with a guaranteed price, guaranteed benefit, guaranteed surrender value structure?

MR. GAMMILL: Yes. First let me say that my opening comments said that all statements I made were not necessarily my opinions. But, yes I do feel that under Scenario B the non-par products with guaranteed prices and guaranteed premiums will stay -- they won't be exactly as we see them today ten years from now, but they will be alive and well. Under high inflation and other scenarios they may not be around at all but I do see changing and levelizing of agents compensation and the hastening of the amortization of the acquisition expenses. Companies will be making profits in the early years -- I see the concepts that we have been a little reluctant to admit, that of higher first year premium than renewal just to help this situation. I see those kind of products. I see a need for the average American -- for the security blanket of long term life insurance protection with a guaranteed premium rate. I don't see necessarily that the life insurance products have to be priced so much differently from other savings forms. I think the problems that the Veterans Administration is having right now with the World War II veterans who are complaining they cannot afford the ever increasing term premiums; I think that problem is going to really shake up the public as it becomes more and more prevalent -- as people who have bought all this term insurance see -- they're going to find out those rates get pretty high at the older ages. I think that participating insurance will be alive and well also. I did not say that it would not be. And I think the flexible premium non-par policy will be alive and well too, but I do think Scenario B is not that unrealistic to the extent that interest rates will come down and as interest rates do come down, we will see many companies not paying the dividends in the next 10 to 20 years that they are being illustrated today, and that will help equalize things. Thus, I don't look for that drastic a change.

MR. TILLER: I would like to comment mostly on Hank's presence here. I think the presence of a senior planning officer for one of the major mutuals must indicate that they're having some of the same concerns about the future that stock companies have. Maybe there is some hope after all for demutualization or something.

MR. RAMSEY: Seriously, I really think that the life of the mutual life insurance company and the life of a stock life insurance company future will be coming much closer together. I think our products will be much more similar, our competition will be much stiffer and I think our similarities will be much greater. We are now learning that we have got to look at things from a profit orientation while still serving our contractholder. However, we've got to look at the realities of the economic investment in the business. I think the differences between the types of companies are going to be very small in the future.

MR. TILLER: I agree there. I was just looking at a competitive analysis one of my younger actuaries made of the 15 largest sellers of life insurance. These 15 companies sold 40% of all the business sold last year; only four of those were stock companies. Other than my own company - which did have the the lowest premium rate - the lowest premium rate was from a mutual.

MR. T. ALLEN PARK: My comment is that I really believe that Scenario A will lead us into Scenario C. One is going to come right after the other. What I am curious about is any comments on another scenario which I feel is a possibility, and that is a deflation depression type scenario after a few more years of the hyper inflation.

MR. LOUIS WEINSTEIN: I would like to ask the people who have had to consider Scenario C, in which the various items that are enumerated do, in fact, occur, except that concurrent with these efforts, tax rates on individual earnings have become rather large, as you imagine that would be necessary. However, the marketing of life insurance does not become part of the regulatory responsibilities of this so-called consumer agency. They choose either not to exercise their authority or they don't have the authority in the first place. It would seem that under this scenario and this revision of the scenario, that Scenario C presents some rather good opportunities for the life insurance industry to provide various programs which would tax shelter at much higher tax rates whatever business we are getting now to protect the American citizen from the Federal tax. It seems to me at higher tax rates, the need to look for higher shelters and the possibility of the industry for providing them, would create better opportunities so this poor scenario which has been maligned and considered a burden for all the speakers who regrettably had been assigned it, could with one minor alteration become a fairly attractive one.

MR. GAMMILL: Lou, the problem I have is with this VAT (Value Added Tax). It is tough to escape a VAT. It is there when you consume the product and I am not sure what type of tax planning devices an individual has under VAT. I know that for example a company can buy a machine to product its widget and get a credit for the tax against the VAT that would otherwise be due because it is putting it into some capital formation, and I know that the taxes are higher if you consume more. But I am not sure what it looks like. Maybe you could enlighten me on that.

MR. WEINSTEIN: I will not enlighten you on it because according to the ethics of the Society, I am disqualified from speaking on subjects on which I am not an expert. I will say this: If my son's orthodontist is buying Texas cattle, and this has been the tradition in the U. S.--of people buying anything--ball teams--getting involved in all sorts of tax shelters, there is an industry called "tax avoidance" and when I say "avoidance" I make sure I pause and be sure I do not say "tax evasion". And the life insurance industry is part of this industry; we have sold a lot of life insurance as a result. Under Scenario C, if we are not stuck with a totally loopholeless tax structure and if we are free to market life insurance as we choose (two very tough "ifs"), the tax rates will be so astronomically high to support all these other items under social welfare legislation that we might be selling an awful lot of insurance just to cover and help provide tax shelters for the American people who are trying to seek some sort of tax relief.

MR. TILLER: Around the reinsurance industry we prefer the term "tax minimization" to "avoidance". It seems to me that the key to Scenario C is the assumption that the internal buildup of cash values will continue to be untaxed. That is the loophole you are talking about really. It has already come under attack from time to time, especially with all the Single Premium Deferred annuities being marketed. Personally, what you are talking about is great. I just find it hard to believe that this would be allowed to stand under a government where small is beautiful and where the government is providing so many things and has a tremendous need for cash. The second problem with your scenario is that with the high tax rates and with the burdens everywhere else, will anybody else have funds available to buy insurance other than perhaps the very rich? This would lead to a shrinking in the number of companies and some specializations. There are some positive aspects, but I am still not as optimistic as you. Maybe I am still pessimistic about the government.

MR. OVERBERG: Well, under your C', you could have a C double prime which would recognize some of the practices that the bureaucrats of other socialized countries have done--where they have made special allowances to people who contribute premiums and the premiums become a tax deduction for you. If the bureaucrats decided that this would be good for the country, then they would do that and that would give us a little niche in sales.

MR. GARY B. CORBETT: Everyone of these scenarios has suggested, and even the prime scenarios have resulted in a very competitive environment in the 80's and the probability that perhaps a number of companies are going to disappear one way or another.

MR. GAMMILL: Yes, that is a good point. What we have is an industry that is coming out of the dark, in my opinion, and into a new era. It is going to have to be managed like a business, so, therefore, all businesses that are well managed will probably survive, whatever the shakeout is, because the industry is going to be managed ably by those who survive it. First of all, we are not going to have a Scenario A, B or C because those were focused as I understand it on the U. S. economy, and we are going to see a focus that is a little bit broader than a U. S. focus. There is going to be a focus on U. S. international marketplaces as opposed to just the U. S. marketplace because the big hitters that do survive it, will be able to put their insurance in the foreign marketplace. But as long as the free enterprise system has the chance to work, the managements that survive this thing will make the companies function, and so the survival for good managements is a realistic thing in any of the scenarios. If you would modify it on a worldwide basis and you would take a Scenario B here and a Scenario B' there and a C and you would look at it worldwide, you would get something else.

MR. MARVIN D. FINEMAN: Scenario C could lead to a situation where the government, although it is willing to allow private enterprise to meet the insurance and tax immunization needs for the very wealthy, will still feel the need to generate revenue to pay for expensive programs so they might arrange that the independent companies that survive will become independent agencies of the U. S. Government which has the right spot of exempting them from the need to be efficient.

MR. TILLER: I would like to poll the audience on something. In my remarks I eluded to the need to work more closely with the regulators. I have picked up some feelings and some comments in the past couple of months that the regulators may be more willing to respond, especially the state regulators. Perhaps this is because of the pending federal intervention and they are trying to protect their domain; I do not know what. I even had one state department actuary call me on a reference from a client and ask whether

Occidental would like to provide somebody to come down and talk to the policy analysts from our part of the country and explain the new products that are coming out and the pressures that are causing this--the tax implications, everything; "take 1, 2, 3 hours, whatever you need." How many of you have felt this in the sense that there may be more a cooperative attitude on the part of the states and less of an adversary role? How many of you feel the other way? (No opinions were expressed from the audience.)